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SENSITIVE

DEPT FOR NEA/MAG; COMMERCE FOR NATE MASON
ENERGY FOR GINA ERIKSON

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TAGS: ECON ENRG EPET PGOV LY
SUBJECT: ENI'S OIL AND GAS DEAL EXTENDED, OTHER COMPANIES WORRY TERMS WILL SET A NEW (UNFAVORABLE) PRECEDENT

REF: 07 TRIPOLI 912

¶1. (SBU) Summary: Soaring oil prices are allowing Libya to press for more stringent long-term contracts with foreign oil and gas producers. A twenty-five year extension for Italian firm Eni North Africa BV, which entailed a sizeable bonus payment and dramatically reduced the company's production share, was recently ratified after lengthy negotiations. The potential impact of Eni's deal is significant. Local observers expect that the National Oil Company's (NOC) success in securing very favorable terms will embolden it to pursue renegotiation of existing contracts with other international oil companies (IOCs). Despite Libya's relatively unique position in terms of unproven reserves, high quality oil and low recovery costs, observers here expect that some IOC's facing potentially long renegotiation periods and dramatically reduced production shares may choose to abandon production efforts in Libya. End summary.

EPSA MODEL TIME-TESTED

¶2. (SBU) Libya's Exploration and Production Sharing Agreement (EPSA) rubric has been the most widely used model for producers in Libya since 1974. Under these agreements, international oil companies (IOCs) receive a fixed percentage of output from the fields involved based on the terms of their bid to explore and develop Libyan acreage. The terms of these agreements, particularly the share of overall production retained by companies, have grown increasingly less favorable to IOCs. Intense competition among foreign oil and gas companies to book reserves in Libya, widely perceived to be one of the relatively few places in the world with significant unproven reserves of sweet, light crude and natural gas, has fueled the trend towards less profitable EPSA's.

¶3. (SBU) As a point of comparison, the standard production share allocation for IOCs in the latest EPSA round (EPSA IV) has been 10-12% of overall production, down from production share allocations of 20% or more that were typical in earlier EPSA rounds. IOC's have accepted stiffer terms based on their high expectations of Libya's hydrocarbon producing potential, the comparatively low cost of oil recovery in Libya, the generally high quality of Libyan crude, Libya's close proximity to European markets and rapidly rising oil and gas prices. Encouraged by the willingness of some IOC's to accept production shares as low as 7 percent under the EPSA IV framework, the NOC - led by former Prime Minister Shukhri Ghanem, reputedly a hard bargainer - has been pressing all IOC's to accept further reductions in their production share allocations to increase Libya's take. Striking a nationalist tone, Muammar al-Qadhafi

explicitly referred in his June 11 speech on the occasion of the "evacuation" of U.S. and British military bases in Libya to efforts to renegotiate EPSA contracts as a manifestation of Libya's continued resolve to resist Western imperialism.

AT LONG LAST, ENI FINALIZES ITS CONTRACT EXTENSION

¶4. (SBU) In October 2007, ENI agreed with the NOC to convert its existing long-term production contracts, which were signed in the mid-1980s under EPSA III terms, to the most recent contractual model under EPSA-IV (reftel). That deal was submitted to Libya's General People's Congress for approval and ratification and was ratified on June 12. Under the new deal, Eni reduced its production share to 12% for oil (down from 35-50 percent for its various fields) and 40% for natural gas (down from 50 percent). The share for gas production will drop to 30% after 2018. In exchange, the NOC extended Eni's EPSA III contracts by 25 years, approved a 3 billion cubic meter (BCM) expansion to the Western Libya Gas Pipeline (WLGP), and the construction of a new 4 million tons per annum LNG facility at Mellitah. Eni accepted less attractive fiscal terms on its blocks (its overall portfolio has fallen by 42% due to lower production share figures), and made a $1 billion non-recoverable payment. Eni's licenses were converted to the EPSA IV model and will now expire in 2042 (for oil) and 2047 (for gas).

OTHER DEALS IN THE OFFING?

¶5. (SBU) Several other major extensions are anticipated in the coming months, including those involving U.S. firm Occidental

Petroleum (along with Austrian partner OMV) and Petro-Canada. Those agreements were signed with the NOC in late 2007, but still require GPC ratification. It is possible the NOC will seek further concessions in light of its deal with Eni. Spain's Repsol and the NOC are renegotiating along the EPSA IV contractual model. The initial deal between Repsol YPF and NOC stipulated a 50-50 split of production; however, the NOC is now seeking a minimum production share of 72 percent.

¶6. (SBU) The NOC has approached numerous other IOCs about extensions, raising the possibility that it will reopen deals that were only concluded a few years ago. Even the U.S. Oasis Group (comprising Amerada-Hess, Marathon and ConocoPhillips), which paid $1.8 billion in December 2005 to return to acreage in Libya's Sirte Basin that it held before the suspension of U.S.-Libyan diplomatic ties and the imposition of U.S. and UN sanctions, may be affected. Libya's relatively modest 59.2 percent production share in that deal has generated preliminary probing by the NOC as to whether the Oasis Group would consider renegotiating, which it has so far successfully opposed.

¶7. (SBU) Comment: With ratification of its revised EPSA contract, Eni has secured a long-term position in Libya, but at a considerable price. Part of the calculus for Eni and other IOC's is the expectation that oil and gas prices are likely to remain high, making non-recoverable bonus payments and lesser production shares tenable from the standpoint of their projects' overall profitability. It is widely expected that the NOC will push hard to renegotiate other extant deals and extensions that involve reduced production shares for IOCs. Its confidence buoyed by favorable market conditions, Libya is playing hardball with the IOC's, sending a clear message that no deal is beyond renegotiation, no matter how recently concluded or how favorable the terms for the NOC. Libya and the IOC's have been here before: a spate of renegotiations and extensions occurred in the late-1960s and early 1970s, driven in part by the then-new al-Qadhafi regime to demonstrate to its people that it was a better steward of Libya's hydrocarbon resources than the Sanussi monarchy had been. As during that period, the current penchant for shifting the goalposts has not been well-received by the IOCs. Despite Libya's relatively unique position in terms of unproven reserves, high quality oil and low recovery costs, observers here expect that some IOCs facing potentially long renegotiation periods (and associated costs of idle personnel

and materiel) and diminished production returns may choose to abandon altogether their production efforts in Libya. End comment.
STEVENS